

Private Letter Ruling: A single-member limited liability company that has elected for federal income tax purposes to be disregarded as an entity separate from its member is similarly disregarded for all Illinois income tax purposes.

December 18, 2002

Dear:

This is in response to your letter dated December 11, 2002, in which you request a Private Letter Ruling on behalf of COMPANY. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of 2 Ill. Adm. Code 1200.110 appears to be contained in your request. The Private Letter Ruling will bind the Department only with respect to COMPANY for the issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that COMPANY and/or any related taxpayer(s) is not currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

The facts and analysis as you have presented them are as follows:

On behalf of our client, the Illinois-based company identified above ("the Company"), we are writing to request an expedited Private Letter Ruling regarding the Illinois Income Tax affects of a corporate reorganization to be implemented effective January 1, 2003. The Company desires to confirm that the reorganization will not affect either the recognition of income nor the calculation or reporting of tax liability under the Illinois Income Tax Act. 35 ILCS 5/101 et seq. In addition, although the disregarded entities that the Company intends to create will hold title to certain assets and may employ or lease certain personnel, the Company wishes to confirm that the Company, and not the disregarded entities, will be entitled to any applicable income tax credits (such as any applicable investment tax credit, training expense credit, etc.) In short, the Company is requesting the ruling to confirm it's [sic] understanding that, after the reorganization of its business operations, the Department will still treat the reorganized enterprise as a single taxpayer for all Illinois Income Tax purposes. This request is made in accordance with Section 1200.110 of Title 2 of the Illinois Administrative Code, and includes the information required pursuant to Section 1200.110, subsections (b)(1) through (b)(7):

The Company, a regular corporation that files an IL-1120, is currently in the business of road building and heavy construction. It is treated, therefore, as a construction contractor under the Sales Tax Acts. As a part of its business, it owns and operates facilities used to manufacture materials, such as asphalt and concrete, used in road building and heavy construction. In addition, the Company owns several vehicles used to transport raw materials, asphalt and concrete products, and construction equipment.

The Company uses most of the asphalt and concrete products it manufactures in its own road building and construction operations. It also sells a portion of those products (less than 50%) to other customers. In the same manner, the Company uses its trucks primarily to transport products and equipment used in its own construction operations. However, it also transports products for other, unrelated customers.

In Illinois Valley Paving, Inc. v. Department of Revenue, 294 Ill. App. 3d 1123 (1998), the court distinguished between the situation where manufacturing functions and construction contracting functions are performed within a single business entity and where the same functions are performed in two separate business entities. It relied heavily on Van's Material

Co. v. Department of Revenue, 131 Ill. 2d 196 (1989), as it concluded “that a reasonable difference exists between combined and separate asphalt and construction operations that corresponds with the qualifying conditions for the [MM&E] exemption – namely, that the machinery or equipment must be used primarily to produce property for sale or lease.” The court went on to note “that taxpayers are free, within limits, to structure their business organizations to minimize taxes. Taxpayers may create a subsidiary and then logically and intelligently arrange their affairs in accordance with the letter and spirit of the law.”

The Company intends to reorganize its operations effective January 1, 2003, to split its business functions into three separate entities –one for construction, one for manufacturing and one for transportation. Its business reason for the reorganization relevant to this ruling is to establish eligibility for exemptions available under the Retailers Occupation Tax Act. It is the Company’s understanding that, for purposes of the Retailers Occupation Tax Act, the Department will treat the new entities as separate business entities, which will result in eligibility for MM&E and rolling stock exemptions. The Company is in the process of requesting a separate private letter ruling to confirm this understanding.

First, the Company intends to transfer all of its manufacturing assets to a newly created single member limited liability company in return for 100% ownership of the new LLC. This LLC (“LLC #1”) will be a manufacturing company, performing all the manufacturing functions currently performed within the Company. For federal income tax purposes, the Company will elect to have LLC #1 disregarded as a separate entity.

Second, the Company intends to transfer all of its transportation assets to a newly created single member limited liability company in return for 100% ownership of the LLC. This LLC (“LLC # 2”) will be a trucking company –an interstate carrier for hire –performing all the transportation functions currently performed within the Company. For federal income tax purposes, the Company will elect to have LLC #1 [sic] disregarded as a separate entity.

The Company is not seeking to change the manner in which its business operations are taxed under the Illinois Income Tax Act. It is the Company’s understanding that, for all Illinois income tax purposes, the Department will follow the choice made by the taxpayer for federal income tax purposes to disregard a new, single member LLC as a separate business entity. Though the Company, LLC #1 and LLC #2 will be three separate entities and (we anticipate) recognized as such for purposes of the Retailers Occupation Tax Act, only the Company should be recognized as a business entity for Illinois income tax purposes, and the LLCs should be treated as divisions of the Company. We are not aware of any legal authorities contrary to this position.

There are no documents relevant to this request for the Department to review. No audit or litigation is pending with the Department regarding these issues. The Department has not previously ruled on the same or a similar issue and then withdrawn it before a letter ruling was issued.

The Company requests a ruling by the Department on the following two questions:

After the reorganization described above, and following the choice by the Company to treat the LLCs as disregarded entities for federal income tax purposes, will the Department continue to

treat the Company as the sole business entity, and treat the LLCs as divisions of the Company in a manner consistent with the federal election, for all purposes of the Illinois Income Tax Act?

After the reorganization described above, although the disregarded entities (the LLCs) will hold title to certain assets and may employ or lease certain personnel, will the Department continue to treat the Company, and not the disregarded entities, as the entity entitled to any applicable income tax credits, such as any applicable investment tax credit, training expense credit, etc.?

RULING

Treasury Regulations Section 301.7701-2(a) states in part as follows:

A business entity with only one owner is classified as a corporation or is disregarded; if the entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner.

Department of Revenue Regulations Section 100.9750(b) states in part as follows:

- b) Corporations. The term "corporation" includes associations, joint stock companies, insurance companies and cooperatives. Any entity, including a limited liability company formed under the Illinois Limited Liability Company Act [805 ILCS 180], shall be treated as a corporation if it is so classified for federal income tax purposes. (IITA Section 1501(a)(4))

1) IRC Section 7701(a)(3) defines "corporation" to include associations, joint stock companies, and insurance companies. This definition is identical to the definition in IITA Section 1501(a)(4), except that the IITA definition includes cooperatives. Accordingly, any entity treated as a corporation for federal income tax purposes must be treated as a corporation for all purposes of the IITA, and no entity (other than a cooperative) that is not treated as a corporation for federal income tax purposes may be treated as a corporation for purposes of the IITA. Thus, any entity electing to be taxed as a corporation under Treas. Reg. Section 301.7701(a) is a corporation for all purposes of the IITA, and any entity that elects not to be treated as a corporation separate and distinct from its owners is not a corporation separate and distinct from its owners. For example:

A) An entity that has elected to be disregarded as an entity separate from its corporate owner pursuant to Treas. Reg. Section 301.7701-3(a) and its corporate owner are a single corporation for all purposes of the IITA.

Applying the foregoing to the facts you have presented, LLC #1 and LLC #2 will be treated as divisions of the Company for all purposes of the IITA. It follows that any income tax credits allowable under the IITA arising from the activities of LLC #1 or LLC #2 shall be credits of the Company.

The facts upon which this ruling is based are subject to review by the Department during the course of any audit, investigation or hearing and this ruling shall bind the Department only if the material

facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

Sincerely,

Brian L. Stocker
Staff Attorney (Income Tax)